



Investment Office

P.O. Box 2749

Sacramento, CA 95812-2749

Telecommunications Device for the Deaf - (916) 795-3240

(916) 795-3400

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AGENDA ITEM 5c

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Update on Investments in Companies Doing Business in Sudan
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Adopt a 7 point position statement on Sudan (Attachment 1).
- IV. ANALYSIS:**

Executive Summary

This is to update the Investment Committee on staff's progress, since the February 14, 2006 Investment Committee meeting, in implementing a constructive engagement plan for companies doing business in Sudan.

Staff recommends that the Investment Committee adopt the proposed 7 point statement (Attachment 1) as it pertains to companies doing business in Sudan. After identifying appropriate companies for engagement, staff plans to:

- Request companies that are supporting the government of Sudan and/or the military, or that are complicit in the genocide occurring in Sudan, not do business with the Sudan government while human rights violations are continuing in Darfur.
- Request that companies doing business in Sudan work with CDA Collaborative Learning Projects, United Nations Global Compact, Business Leaders Initiative on Human Rights and United Nations Development Program

to improve the transparency of their business operations and complete complicity reports relating to human rights violations in Sudan.

- Request that companies doing business in Sudan work with the above entities and NGOs, as well as others, to bring an end to human rights violations occurring in Sudan.

Staff has discovered through internal research and third party sources additional portfolio companies that have been identified as doing business in Sudan. Each company has been sent a letter of inquiry requesting full disclosure of their direct or indirect business activities in Sudan by May 12, 2006. The letter of inquiry was the same letter CalPERS sent to the original five companies (ABB, Alcatel, Royal Dutch Shell, Siemens, and Total) on June 30, 2005.

In collaboration with the Business Leaders Initiative on Human Rights (BLIHR) and CDA Collaborative Learning Projects¹ (CDA), staff wrote to Alcatel, Royal Dutch Shell, and Siemens on April 5, 2006 encouraging them to work with BLIHR and or CDA to prepare Impact Reports and complete complicity assessments. ABB is one of ten original members of BLIHR and is currently completing a complicity assessment. Staff has confirmed that all four of the original companies identified as doing business in Sudan have formally supported the United Nations Global Compact and are communicating their support in implementing the ten principles via either Communication on Progress reports or company websites. Upon receipt of the responses to our letter of inquiry, staff will determine which of the additional companies identified should be encouraged to work with BLIHR and CDA or formally support the UN Global Compact.

The Office of Foreign Asset Control (OFAC) has levied penalties against The Coca Cola Company for violations of the federal sanction program for Sudan. In response, staff submitted a letter of inquiry to Coca Cola. Coca Cola responded stating that the company does not have any business investments in Sudan and does not do any business with the government of Sudan, and further that they have addressed the alleged violations.

On March 16, 2006, The Regents of the University of California (Regents) voted unanimously to divest from nine companies that they believe were clearly shown to be providing monetary or military support to the government, with little to no interest in the situation in Darfur or in providing any humanitarian benefits to the Sudanese people. CalPERS currently owns no equity or fixed income securities in these nine companies.

Staff remains committed to its constructive engagement plan.

¹ CDA Collaborative Learning Projects was formally known as Collaborative Development Action.

Background

Over the last several years, ethnic and racial tension in the Sudan has escalated to the level the U.S. Department of State characterizes as “genocide.” In recent months, it has been suggested that companies that do business in Sudan may thereby be furthering or condoning the nation’s support for terrorism or the egregious human rights violations occurring in that country. A company associated with the atrocities taking place in Sudan poses a serious risk to creating sustainable and responsible long-term value. Any such company runs myriad risks including but not limited to federal and international sanctions, substantial fines and penalties imposed by authorities, an impairment of their ability to raise capital in public markets as well as long term reputational damage.

As presented in the February 14, 2006 agenda item (Attachment 2), staff’s efforts to address the very serious and challenging situation in Sudan included the following:

- Continue to actively engage portfolio companies that are reported to have business activities that support genocide and human suffering in Sudan;
 - Explore the possibility of working with BLIHR, CDA, and the World Bank.
 - Explore opportunities to use the UN Global Compact as a basis for engagement.
- Engage companies against which OFAC has levied penalties for violating federal sanction programs specific to activities in Sudan.
- Continue to seek new and reliable sources to identify and engage companies doing business in Sudan. Options currently being explored include the following:
 - Identify a third party consultant, who has the expertise to effectively engage these international companies.
 - Explore opportunities to utilize CalPERS Corporate Governance Resource Pool to either identify global third party sources or engage companies with business operations in Sudan.
- Continue to work with the Sudan coalition and to collaborate where appropriate.

Actions since February 14, 2006, are described below.

CalPERS’ Recommendation

To ensure sustainable long-term returns, CalPERS uses its leverage as a shareowner to constructively engage portfolio companies whose corporate

governance, social, and environmental practices could lead to value destruction. Company engagement, through active ownership, provides CalPERS the opportunity to more effectively alter the actions of portfolio companies that impede sustainable long-term economic returns. Ownership and its associated rights, enables the System to effect positive change at the portfolio company level.

Staff recommends that the Investment Committee adopt the proposed 7 point position statement in Attachment 1 as it pertains to companies doing business in Sudan. After identifying appropriate companies for engagement, staff plans to:

- Request companies that staff determines to be supporting the government of Sudan and/or the military, or that are complicit in the genocide occurring in Sudan, not do business with the Sudan government while human rights violations are continuing in Darfur.
- Request that companies doing business in Sudan work with CDA Collaborative Learning Projects, United Nations Global Compact, Business Leaders Initiative on Human Rights and United Nations Development Program to improve the transparency of their business operations and complete complicity reports relating to human rights violations in Sudan.
- Request that companies doing business in Sudan work with the above entities and NGOs to bring an end to human rights violations occurring in Sudan.

Progress Update

Additional Company Identification

Through internal research and third party sources, additional portfolio companies have been identified as doing business in Sudan. The additional companies are Alstom SA, CNPC (Hong Kong) Ltd., Ericsson (LM) Tel, Finmeccanica S.p.A., Marathon Oil Corp., Reliance Industries, Rolls-Royce Group PLC, Schlumberger Ltd., Stolt-Nielsen SA, Sulzer AG, ThyssenKrupp AG, and Vodafone Group PLC. Together with the Connecticut State Treasurer's Office and the New York State Comptroller's Office, CalPERS sent each of the companies a letter of inquiry requesting full disclosure of their direct or indirect business activities in Sudan. Attachment 3 contains a copy of the letter that was sent to Ericsson. The remaining companies received identical letters. The companies were asked to respond by May 12, 2006.

Identification of Third Party Consultants

Staff continues its efforts to identify companies for engagement that are doing business in Sudan. In addition to identifying companies through third-party sources such as the Office of Foreign Asset Control (OFAC) and the Sudan Coalition, staff continues its efforts to identify credible third-party consultants to assist in the identification of companies doing business in Sudan.

Since the last update to the Investment Committee, staff has engaged F&C Asset Management. F&C Asset Management (F&C) is a leading investment company located in the United Kingdom with a strong presence in the corporate governance arena. F&C is currently developing a product to assist its clients with their engagement of companies identified as doing business in Sudan.

Staff also maintains an ongoing dialogue with Oxford Analytica to explore potential opportunities to assist CalPERS' efforts to identify and engage companies doing business in Sudan.

Business Leaders Initiative on Human Rights (BLIHR) / CDA Collaborative Learning Projects (CDA)

Staff continues to engage CDA and BLIHR in order to explore opportunities in which the organizations can assist CalPERS with its constructive engagement plan. Staff has encouraged Alcatel, Royal Dutch Shell and Siemens to work with BLIHR or CDA or both to determine the effect of the companies' business operations in Sudan. CDA, through its Corporate Engagement Project (CEP), helps companies prepare and publish Impact Reports on the companies' business operations in Sudan while BLIHR assists companies in completing and publishing complicity assessments. ABB is one of ten original members of BLIHR and is currently conducting a complicity assessment of its business operations in Sudan. Attachment 4 contains the letter that was sent to Alcatel. Royal Dutch Shell and Siemens received a similar letter. Further, staff will encourage other companies identified as doing business in Sudan to work with BLIHR and CDA including the twelve additional companies with whom staff recently initiated engagement.

The United Nations Global Compact

CalPERS' portfolio companies identified as doing business in Sudan will be encouraged to formally support the United Nations Global Compact and its principles. Through the Global Compact's policy on Communication on Progress (COP), companies are strongly encouraged to provide COP reports, such as an annual corporate sustainability report (CSR), communicating the company's progress in implementing the ten universal principles in the areas of human rights, labor, the environment, and anti-corruption.

With regard to the original four companies that CalPERS is currently engaging, all four publicly support the Global Compact, confirmed via the Global Compact website (www.unglobalcompact.org). In addition, the four companies have either issued COP reports which are available through the Global Compact website (ABB, Alcatel, and Royal Dutch Shell), or, in the case of Siemens, are communicating ways in which they support the Global Compact via the company website. Of the additional twelve companies, staff has identified one (Ericsson) that currently formally supports the Global Compact. As with CDA and BLIHR, staff will encourage the remaining eleven companies to formally support the Global Compact and its principles.

United Nations Development Program (UNDP)

On May 17, 2006, the UNDP will host a summit in Khartoum, Sudan, and ABB and Royal Dutch Shell will serve as co-hosts and provide sponsorship for the meeting. The summit is titled "Public Private Partnerships in Emerging Markets" and its purpose is to have extensive discussions about the importance of corporate governance and respect for human rights. UNDP and Allen Miller, an independent human rights consultant and attorney, will set the agenda for the meeting. Approximately 30 to 40 participants representing Sudan government ministries, local and international Non Government Organizations, international agencies, companies, and BLIHR will attend the summit. BLIHR is expected to subsequently publish a public report on the summit.

The World Bank

Staff has spoken with the World Bank regarding its current presence in and plan for Sudan. The World Bank recently opened an office in Khartoum as a result of the Comprehensive Peace Agreement, but is not currently engaged in any project funding. The World Bank has communicated to the government of Sudan that project funding will not occur until the government has brought a resolution to the atrocities occurring in Darfur.

The Sudanese government currently owes the World Bank \$350 million, the International Monetary Fund \$1.5 billion and the African Union \$100 million. The government has communicated its desire for the World Bank to resume project funding activity in the country at concessional rates as well as provide Heavily Indebted Poor Countries (HIPC) debt relief. The Debt Initiative for HIPC was launched to provide debt relief to the world's poorest and most heavily indebted countries, thereby improving prospects for economic growth and reducing poverty in those countries.

Staff will continue to monitor and engage the World Bank regarding its plans for Sudan.

Office of Foreign Asset Control (OFAC) - Update

Staff continues to monitor the U.S. Department of the Treasury's OFAC for companies against whom OFAC has levied penalties for violating federal sanction programs specific to activities in Sudan. Since the last update to the Investment Committee in February 2006, OFAC has levied penalties against The Coca Cola Company for violations of the federal sanction program for Sudan.

Staff submitted a letter of inquiry to Coca Cola (Attachment 5) requesting a written explanation of the circumstances surrounding the alleged violation, including the facts that led OFAC to levy the penalty against Coca-Cola as well as any measures Coca-Cola has taken to prevent any future business activities from being performed in Sudan other than what is permitted under the OFAC license. Coca Cola's response can be found in Attachment 6.

Coca Cola stated in its response that the company does not have any business investments in Sudan and does not do any business with the government of Sudan. Coca Cola does have a license granted to it by OFAC to sell the company's beverage base to a private company who serves as a bottler in Sudan. In July 2004, Coca Cola uncovered and voluntarily reported to OFAC possible violations of its OFAC license. After extensive investigation by both the company and OFAC, Coca Cola agreed to a civil settlement of \$136,500. Coca Cola continues to improve its compliance program and has taken disciplinary measures against those involved in the violation of the OFAC license.

The Regents of the University of California - Update

On March 16, 2006, The Regents of the University of California (Regents) voted unanimously to divest from nine companies² with business operations in Sudan. The divestment is conditional on the passage of legislation by the California Legislature, and with the signature by the Governor, providing indemnification for past, present, and future individual Regents, and the University, its officers, agents, and employees, for all costs and defense of any claim arising from the decision to divest. Upon enactment of the legislation, the University will have a period of 18 months in which to divest from the nine companies. The Regents' agenda item can be found in Attachment 7.

² Bharat Heavy Electricals Ltd., China Petroleum and Chemical Corp (Sinopec), Nam Fatt Co. Bhd., Oil & Natural Gas Co. Ltd., PECD Bhd., PetroChina Company Ltd., Sudan Telecom Co. Ltd. (Sudatel), Tafneft OAO, and Videocon Industries Ltd.

The nine companies were selected for divestment based on the Regents' Sudan Divestment Study Group's (Study Group) decision that the companies were clearly shown to be providing monetary or military support to the Sudan government, while showing little or no interest in the violence in Darfur or in helping to improve the welfare of the Sudanese people. Subject to the enactment of the pending legislation, future investment in the nine companies would not occur until it is determined that a company has materially improved its operation and is no longer thought to be contributing to the suffering in Darfur, or until the situation in Darfur has improved to the point that investment in the companies is believed to be in the best interest of the Sudanese people. A brief summary of the nine companies and their involvement in Sudan can be found in Attachment 8.

While none of CalPERS' portfolios contain shares in the nine companies from which the UC propose divestment, two of the nine companies are in benchmarks of 12 CalPERS active international equity managers. The two companies are Bhurat Heavy Electricals and Oil and Natural Gas Co. These companies have benchmark weights ranging from 0.025% to 0.188% and 0.039% to 0.281%, respectively. As a result it should be noted that CalPERS' investment managers could potentially purchase these securities in the future given that the two companies are in the managers' benchmarks.

The Study Group identified the remaining companies on its confidential list of companies doing business in Sudan as either "no action required" or for continued engagement. The Regents voted to continue engagement with four additional companies by sending letters of concern about the role of business revenue in contributing to the violence in Darfur. Those companies are Finmeccanica SpA, Harbin Power Equipment Co. Ltd., Lundin Petroleum AB, and Schlumberger Ltd.

CalPERS does hold shares in two of the four companies that the Regents have voted to engage: Finmeccanica and Schlumberger. Staff has initiated engagement with the two companies; they are among the additional companies that staff identified previously in this agenda item.

California State Teachers' Retirement System (CalSTRS)

On April 6, 2006, CalSTRS staff presented an update to the CalSTRS Investment Committee on the issue of Sudan. Following the update, the CalSTRS Investment Committee unanimously approved the following motion:

"It is the intent of the Board to move forward to divest its holdings from companies identified as doing business with the Government of Sudan, taking into consideration the same general criteria utilized by the UC Regents and

subject to the investment staff determining that such action would be prudent and consistent with the System's fiduciary duties and that suitable alternative investments would be available. Staff is directed to bring back at the June meeting any appropriate analysis, legal opinions, and procedural requirements as required. Such action would be subject to the indemnification of the Board members, consistent with the indemnification of the UC Regents."

California State Legislation

A bill titled "Public Employee Retirement System: Investments: Sudan," AB 2941, is currently making its way through the California State Legislature. The Office of Governmental Affairs will discuss AB 2941 in more detail in a separate agenda item. In short, AB 2941 will prohibit investments by the Public Employees' Retirement System and the California State Teachers' Retirement System in entities doing business with the government of Sudan; and will require divestment by January 1, 2008 in entities doing business with the government of Sudan. In addition, the two Systems will be required to provide an annual report to the Legislature beginning in 2007. The prohibition will continue until the Department of State and Congress determine the government of Sudan has halted the genocide in Darfur for 12 months or the United States revokes its current sanctions against Sudan.

Recommendation

Staff recommends that the Investment Committee adopt the proposed 7 point position statement (Attachment 1) as it pertains to companies doing business in Sudan.

V. STRATEGIC PLAN:

This item is a product of the 2005-2006 Global Equity Annual Plan.

VI. RESULTS/COSTS:

Over the course of last year, the primary cost to the Fund for this initiative has been significant staff time and travel costs associated with engagement activities.

Dennis A. Johnson
Senior Portfolio Manager
Corporate Governance

Christianna Wood
Senior Investment Officer
Global Equity

Anne Stausboll
Interim Chief Investment Officer